
Zayre:
10 million
customers
Zayre's
got
it!
compare Z*
Z*
annual
report
1975
*compare...you can't do better than Zayre.
Zayre is
Super
Santa!
compare... Z*

about the cover . . .

A series of posters used in our stores during the Fall and Holiday Season of 1975 in conjunction with our program to improve our visual images in signs, graphics, and merchandise presentation.

FINANCIAL HIGHLIGHTS

Fiscal Year Ended Last Saturday in January
(Dollars in Thousands Except per Share Amounts)

	1976 (53 weeks)	1975 (52 weeks)
Net Sales	**$1,084,011**	$1,045,541
Pre-tax Income from Continuing Operations	**14,101**	878
Income from Continuing Operations	**6,856**	664
Income (Loss) from Discontinued Operations	**(1,916)**	168
Net Income	**4,940**	832
Working Capital	**134,042**	128,825
Shareholders' Equity	**114,481**	109,524
Net Income per Common Share:		
Primary and Fully Diluted		
Income from Continuing Operations	**$1.37**	$ .11
Income (Loss) from Discontinued Operations	**(.39)**	.03
Net Income	**.98**	.14

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ANNUAL MEETING

The 1976 annual meeting will be held at 11:00 A.M. on Tuesday, June 1, 1976, in the Forum Room, State Street Bank and Trust Company, 225 Franklin Street, Boston, Massachusetts

FORM 10-K

Information concerning the Company's operations and financial position is provided in this report and in the Form 10-K Report filed with the Securities and Exchange Commission. A copy of the 10-K Report may be obtained without charge by writing to Zayre Corp., Shareholder Relations, Framingham, Massachusetts 01701.

ZAYRE STORE CLUSTERS

Chicago, Illinois	28
Boston, Massachusetts	18
Miami, Florida	14
Providence, Rhode Island	12
Tampa–St. Petersburg, Florida	12
Washington, D.C.	11
Cleveland, Ohio	9
Atlanta, Georgia	7
Western Massachusetts	7
Minneapolis–St. Paul, Minnesota	7
Pittsburgh, Pennsylvania	7
Orlando, Florida	6
Birmingham, Alabama	6
Greensboro–High Point, N. C.	6
Indianapolis, Indiana	5
Charlotte–Kannapolis, N. C.	5
St. Louis, Missouri	5
Cincinnati, Ohio	4
Hartford, Connecticut	4
Norfolk–Portsmouth, Virginia	4
Worcester, Massachusetts	4
Central Illinois	4
Youngstown, Ohio	3
Scranton–Wilkes-Barre, Penn.	3
Memphis, Tennessee	3
Akron–Canton, Ohio	3
Southeastern Massachusetts	3
Portland, Maine	3
Macon, Georgia	3

To Our Shareholders:

Zayre achieved a major recovery in earnings in 1975 and implemented policies and programs which, we firmly believe, will result in further gains in the year ahead.

Sales rose to $1,084,011,000, a gain of 3.7 percent over the previous year. Capped by a strong fourth quarter, net operating income totalled $6,856,000, or $1.37 per share, up sharply from $664,000, or 11 cents per share, in 1974. It should be noted that 1975 earnings include a reserve equivalent to $750,000 after taxes, to cover the projected costs of closing and subletting our six Spree! toy and leisure-time specialty stores.

The Company has also provided a separate reserve of $1,880,000 after taxes, or 39 cents per share, to cover all current and future costs connected with the discontinuance of the Zayre-owned revolving charge credit plan and the sale of the related receivables. After this non-recurring charge, net earnings for 1975 were $4,940,000, or 98 cents per share.

Sales growth in 1975 met our projections. This growth was internal. As planned, no new Zayre stores were added during the past year. Furthermore, this growth was achieved even though we chose to "give up" an anticipated $15 million in sales of certain low margin, slow moving durable goods as part of our program to improve merchandise mix. As the year progressed, a gradual improvement in the tone of sales, reflecting somewhat better levels of consumer confidence, became evident and culminated in a strong December.

Our expenses were well controlled in the face of continued inflationary pressures. As a percentage of sales, store expenses were held to the previous year's level. The aggregate dollar cost of store supervision and home office overhead was actually less than in 1974. Overall, utility costs were held to a ten percent increase; telephone, travel, and supply costs were reduced. Restructuring supervisory staffs increased store operating efficiency. We are continuing to apply progressive industrial engineering techniques to the substantial portion of store work involving the physical movement of merchandise. Despite the steady rise in freight rates and minimum charges, more refined routing techniques and the consolidation of small shipments have helped to achieve a lower ratio of freight expense to sales.

Notably, interest costs decreased by $5.2 million due to the marked decline in money rates from the abnormally high levels of 1974 as well as our reduced use of short-term borrowing during the course of the year.

A strong improvement in merchandise gross margins was a key objective in our planning for 1975. To reach this goal, concentrated effort was placed on the development of a more profitable merchandise mix. Large sales gains were registered throughout all of our apparel areas; menswear was especially robust.

In durables, we reallocated our inventory investments to emphasize "take with" merchandise in contrast to "delivery" items. White goods — namely stoves, refrigerators, washers and dryers — have been gradually phased out. Also, we have reduced assortments of console television sets and higher-priced cameras.

Zayre continues to sell a large volume of portable TV sets, room air conditioners, popular-priced photography equipment and electrical appliances. Currently, more inventory and store space are being devoted to higher-margin, faster-turning categories such as audio and stereo components, citizen-band and portable radios, scanners, digital watches and hand-held calculators.

During the year, we developed a system which provides swifter replenishment for the fast-selling, high-margin impulse items stocked at the checkout lanes. A new program was installed to control the special merchandise presentations in the major aisles of our stores. Stress is placed upon offering constantly changing, exciting values in wanted merchandise, while care is taken to assure that the mix includes selections of average-margin as well as low-margin items.

Another significant factor in the improvement of merchandise gross margins was the reduction in markdowns from the unusually high levels of 1974. We began 1975 with tight inventories and kept them lean throughout the year. Measures were taken to significantly improve the control of assortments in

hard-goods departments. Further, we enjoyed a successful Holiday selling season.

Improved gross margins were achieved even though promotional retail price reductions related to advertising were more than in 1974. Also, we again experienced an increase in inventory shrinkage. Unfortunately, this has become a major cost of doing business in the retail industry. The Company is closely reexamining all aspects of its security systems and has challenged the entire organization to help contain this problem.

Zayre stores have excellent potential for further productivity gains. To tap that potential, management is placing great stress on the fundamentals of our business. We are a discount retailer able to offer strong values by maintaining a low overhead, but our customers expect well-kept attractive stores. We rely heavily on self-service; payroll, our largest expense, must be carefully budgeted and controlled. At the same time, we must provide sound service to our customers. Each of our 254 stores carries tens of thousands of different items. Although it is a complex task to have the right merchandise in the right place at the right time, Zayre is committed to this objective, day in and day out.

These principles and many more are woven together in Zayre '75, a formal program launched during the year which fired the enthusiasm and imagination of our entire organization. This is an ongoing program; today, we call it Zayre '76. Within each store, the allocation of space and the layout of the many departments are analyzed and adjusted for greater profit production. Signs are streamlined and standardized, wall decor simplified and exciting new graphics, designed to complement merchandise presentation, are installed. We are using more compelling merchandise displays in our apparel departments and, in the coming months, will be making similar improvements in all other categories.

Currently, we are developing a more contemporary design for the store exteriors. We expect these improvements to become an integral part of all major store renovations starting in 1977.

In our merchandise assortments we are striving for greater depth in the most wanted items and on being in stock constantly in basics and advertised goods. We are concentrating on building profitable sales and not just volume for the sake of volume.

This same emphasis and concentration upon strengthening fundamentals is being applied to the financial areas of our business. In the early years of the industry, Zayre, like most discount retailers, expanded rapidly. Five years ago, however, we adopted a policy to gradually improve our capital structure. Since then, the balance sheet ratio of long-term debt to equity has improved from 1.43 to .99 and, if real estate mortgages are excluded, from .96 to .73. In that same period of time, book value per share has grown from $15.52 to $23.29 and our working capital now amounts to $134 million.

As part of our program to bring capital spending more in line with internally generated funds, we decided several years ago to reduce the pace of new Zayre store openings. This proved to be a sound business judgment in light of the subsequent recession and the concurrent tightening of the money markets.

Since no new Zayre stores were added in 1975, capital spending was reduced substantially to $5 million, a figure well below our annual depreciation of $12 million. Looking ahead, our capital spending will be growing, but, in step with our anticipated earnings growth. The largest share of these expenditures will be devoted to improving existing stores in order to enhance their profitability.

Some time ago, management decided not to expand our Spree! toy and leisure-time specialty stores. This past year we concluded that the resources involved in this operation — both management time and capital investment — should be used more productively. Accordingly, the six stores are being closed and a reserve of $1.6 million before taxes has been charged to operations for the year just ended to cover expenses including the projected costs of subletting these units.

While charge sales are not a major portion of our business, they are an important service to many of our customers. Recognizing the increasing acceptance of

the national bank cards, Master Charge and BankAmericard, we decided to free up the considerable amounts of Company capital and bank lines involved in our own custom card plan. We chose to do so in a way that would least disturb customer service through an arrangement with the General Electric Credit Corporation, which has been operating a Zayre non-recourse custom card plan in 101 of our stores for many years.

GECC will extend its operations to the 52 stores where Zayre has been conducting its own plan. It is expected that the transaction will be concluded by July when the installation of new on-line electronic credit authorization terminals in the affected stores has been completed.

Consequently, we are phasing out the operations of our wholly-owned finance subsidiary, Zayre Credit Corporation. Of the $23.5 million total outstanding customer receivables in these stores at year-end (anticipated to be somewhat less at the time of closing), GECC has agreed to purchase substantially all of the more current accounts on a discount basis. Accounts not purchased by GECC will be collected by the Company. An after-tax reserve of $1.9 million has been established to cover current and future non-recurring costs for disposing of all of these receivables.

The financial measures taken over the past few years have all helped to reduce short-term bank borrowings. In 1975, usage of available bank lines averaged 39%, down from 70% in 1974. Further, all bank borrowings made for seasonal merchandise requirements were retired well before year-end and for a longer period than in the past.

Retail store rentals have escalated dramatically over the years due to the upward trend in construction costs and long-term interest rates. This enhances the value of our present leases since our costs under those leases are below today's costs for equivalent retail space. This provides a powerful incentive for investing in existing stores to make them more productive from a sales and earnings standpoint. In the future, we will be adding new Zayre stores but at a more modest rate than in the past and on a highly selective basis. Some are expected to be takeovers of existing retail locations. In keeping with our policy of the past few years, new stores will be located within the major marketing areas we already serve or nearby smaller communities.

Our portfolio of leases is constantly under review. We carefully examine stores with less than average operating margins as well as those few where demographic changes may dampen long-term prospects. Because rents have risen, we are in a position to dispose of a number of these units before their leases expire, absorbing the related closing costs with no significant effect upon earnings. This permits us to reapply the capital involved more productively. In the past five years, we have disposed of 12 major units in this manner. Five of these transactions were completed since our last annual report and all closing costs are included in the past year's statement of operations.

Looking at 1976, a number of factors encourage us to expect stronger sales than in 1975. The tone of business to date supports this view. The economic outlook is positive; consumer confidence is on the mend. Our store managers have raised store standards, especially in customer service and merchandise presentation. Our employees appreciate the changes and their enthusiasm is evident. Most importantly, our customers are responding favorably.

Merchandise gross margins should increase again this year. We are continuing to enhance our mix of sales. Also, the improvements effected in 1975 will be in place for all of the current year. Advertising programs will be as strong and as comprehensive as ever. With an improving economy, however, the related price adjustments are expected to be somewhat lower than in 1975.

We intend to maintain, or even reduce, the level of expenses as a percentage of sales. Increased volume should more than offset the expected rise in dollar amounts of payroll, utility and other costs. Our interest costs are expected to be approximately the same as in 1975.

These factors, together with the many positive developments described in this letter, make us

confident that Zayre Corp. will achieve further earnings gains in 1976. Our focus on the fundamentals of productivity and profitability furnishes a springboard for an exciting and rewarding future. Although it is gratifying that 1975's operating results were so much better than in the prior year and that excellent progress was achieved in strengthening our overall financial structure, earnings have yet to reach levels acceptable to management. We are committed to this objective.

Our warmest thanks and appreciation go to the 25,000 Zayre employees whose efforts made this turnaround possible. We gratefully acknowledge the continued strong support and encouragement of our vendors, our financial institutions and our shareholders.

Respectfully submitted,

Sumner Feldberg
SUMNER FELDBERG
Chairman of the Board

Stanley H. Feldberg
STANLEY H. FELDBERG
President

DIRECTORS AND SENIOR MANAGEMENT

LEFT GROUP

Left to Right
(Standing)

David Kaplan
Exec. Vice Pres. Sales/Operations

John F. McGowan
Senior Vice Pres. Sales/Operations

Malcolm L. Sherman
Senior Vice Pres. General Merchandise Mgr.

Arthur F. Loewy
Senior Vice Pres. Finance and Treasurer

CENTER GROUP

Left to Right
(Standing)

Albert M. Kronick
Director

Newton A. Lane
Director

(Seated)

Robert F. Shapiro
Director

Burton S. Stern
Exec. Vice Pres. Merchandising

Not shown: N. Preston Breed, Director

RIGHT GROUP

Left to Right
(Standing)

Stanley H. Feldberg
President

Milton L. Levy
Senior Vice Pres. Real Estate

Vincent C. Ziegler
Director

Walter J. Salmon
Director

(Seated)

Sumner Feldberg
Chairman of the Board

Max Feldberg
Honorary Chairman

FIVE-YEAR SUMMARY

Fiscal Year Ended
Last Saturday in January
(Dollars in thousands except per share amounts)

	1976 (53 weeks)	1975	1974	1973	1972
Summary of Operations:					
Net sales, excluding sales of leased departments	**$1,084,011**	$1,045,541	$ 996,422	$ 934,310	$ 801,101
Cost of sales, including buying and occupancy costs	**850,680**	827,159	777,705	735,247	625,115
Selling, general and administrative expenses	**196,117**	188,773	177,661	158,543	137,051
Depreciation and amortization	**11,971**	12,653	13,089	12,438	10,943
Interest cost	**11,142**	16,307	12,301	9,593	8,640
Less interest capitalized	**—**	(229)	(178)	(173)	(167)
Total expenses	**1,069,910**	1,044,663	980,578	915,648	781,582
Income from continuing operations before income taxes	**14,101**	878	15,844	18,662	19,519
Provision for income taxes	**7,245**	214	7,151	8,234	9,502
Income from continuing operations	**6,856**	664	8,693	10,428	10,017
Discontinued operations:					
Income (loss) from discontinued owned credit plan, net of applicable income taxes	**(36)**	168	419	122	—
Loss on disposal of owned credit plan, net of applicable income taxes	**(1,880)**	—	—	—	—
	(1,916)	168	419	122	—
Net income	**$ 4,940**	$ 832	$ 9,112	$ 10,550	$ 10,017
Average number of common shares outstanding	**4,881,859**	4,870,425	4,881,658	4,846,017	4,779,611
Net income per common share:					
Primary					
Income from continuing operations	**1.37**	.11	1.75	2.12	2.06
Income (loss) on discontinued owned credit plan	**(.39)**	.03	.09	.03	—
Net income	**$ .98**	$ .14	$1.84	$2.15	$2.06
Fully diluted					
Income from continuing operations	**1.37**	.11	1.70	2.03	1.95
Income (loss) on discontinued owned credit plan	**(.39)**	.03	.07	.02	—
Net income	**$ .98**	$ .14	$1.77	$2.05	$1.95
Stores in Operation:					
Self-service Department Stores	**254**	258	251	232	204
Apparel Specialty Shops	**34**	36	49	54	57
Fabric Shops	**44**	46	42	42	29
Gasoline Stations	**95**	95	94	85	68
Discount Food Supermarkets	**10**	10	9	9	9
Toy and Leisure-Time Stores	**5**	6	6	6	11
Promotional Ladies' Apparel Stores	**87**	62	46	33	23
Other Financial Data:					
Current assets	**$ 231,617**	$ 233,459	$ 240,793	$ 220,606	$ 200,501
Current liabilities	**$ 97,575**	$ 104,634	$ 110,862	$ 100,944	$ 98,178
Working capital	**$ 134,042**	$ 128,825	$ 129,931	$ 119,662	$ 102,323
Current ratio	**2.37**	2.23	2.17	2.19	2.04
Shareholders' equity	**$ 114,481**	$ 109,524	$ 108,706	$ 99,539	$ 88,234
Number of common shares outstanding at year-end	**4,914,667**	4,864,767	4,874,817	4,853,717	4,821,273
Equity per common share	**$23.29**	$22.51	$22.30	$20.51	$17.98

FINANCIAL AND OPERATING REVIEW

Company Profile — The major business of Zayre Corp. is the operation of a chain of self-service, convenience, general merchandise discount department stores. 215 are clustered in 35 major metropolitan markets in the eastern half of the nation; the remainder are in 39 smaller communities (see map on page 2). The population of these markets is some 50 million, or about 25 percent of the nation.

There are approximately 100 merchandise departments in each store serving most of the clothing, home and recreational needs of the family. Leased departments account for about three percent of total store volume.

Zayre stores range in size from 45,000 to 130,000 square feet; the typical store covers 73,000 square feet. The gross area of all Zayre stores is 18,965,000 square feet. Virtually all stores are on one floor with approximately 77 percent of the space devoted to selling area. Most Zayre stores are in suburban strip shopping centers; they are easily accessible, and have generous shopping hours and ample free parking. Zayre is usually the major tenant in these centers which generally include at least a food supermarket and a drugstore. There are also some freestanding Zayre stores, and others which are located in large, regional shopping malls.

The Company maintains a network of five distribution centers with 2,000,000 square feet of space. About 64 percent of our merchandise is processed through these centers; the balance flows directly from vendors to stores.

The first two Zayre stores were opened in 1956 in Hyannis and Roslindale, Massachusetts. However, the origins of the firm trace back to 1919 and a hosiery jobbing business that subsequently developed into a chain of ladies' apparel specialty stores. Originally centered in New England, Zayre today derives approximately 33 percent of its revenues from the Northeast, 42 percent from the Midwest, and 25 percent from the Southeast.

Specialty Stores — Hit or Miss, our promotional ladies' apparel operation, continues to develop rapidly and successfully and has become a significant factor in this growing field.

Simple, functional stores, tight control of operating expenses, rapid merchandise turnover, high sales per square foot, and low capital requirements are characteristics of this operation.

The store focus is on exciting fashions in sportswear, dresses, coats, and accessories for misses and juniors. Most merchandise represents special purchases from well-known makers. The brand labels are removed and the prices are set well below normal retail. The chain pursues an aggressive markdown program to assure high turnover, and fresh, constantly changing assortments.

Because of its under-selling policy, Hit or Miss shops are not located in expensive regional malls. Instead, the units are generally in strip or community shopping centers and are leased for relatively short periods, five to ten years with renewal options. Stores range in size from 2,500 to 5,500 square feet and average 4,000 square feet.

We have continued to build management depth into the operation and to expand its scope. Originally started in the Boston area, the chain has now spread throughout New England and, in recent years, heavily into the Philadelphia, Washington, Baltimore, New Jersey and Pennsylvania markets. 25 new stores were opened in 1975, up from 16 in the prior year, bringing the number in operation at year-end to 85. As many as 30 additional units will be added in 1976.

On the other hand, we are pursuing a policy of restraint relative to new openings in our **Beaconway** fabric specialty shop operation. These stores, located primarily within New England, are under the direction of the management group which is responsible for the fabric and yarn departments in our 254 Zayre stores. As such, they are one of the larger fabric retailing operations in the country. This management team is concentrating upon the development of further volume within present units so as to achieve improved earnings.

Bell/Nugent, our chain of conventional ladies' apparel specialty shops has undergone a marked revitalization. Its new prototype, **On Stage**, is performing well in the three major, enclosed mall, regional shopping centers in which the concept has been introduced. These are dramatic stores, featuring medium-to-better price sportswear and ready-to-wear from famous makers. Two to three more such units are expected to be added this year.

Gasoline Stations — There are now 95 Zayre stations in operation, all but six of which are located on the parking lots of our discount department stores.

Remex, a joint venture started in 1972 and owned equally by the Company and Research Fuels, Incorporated, of Houston, Texas, operates all of these

stations except the seven that are part of our Shoppers' City division in the Minneapolis-St. Paul area.

Gasoline marketing is highly cyclical and, currently, quite competitive. The resultant pressure on margins reduced our share of the pre-tax income of Remex to $320,000 this year as against $1,150,000 in 1974. It should be noted that this income is in addition to the stream of payments from the joint venture that covers our underlying lease costs for the stations as well as fully servicing our capital investment in that operation.

The Leasing Subsidiaries — Zayre Leasing Corporation, a wholly-owned subsidiary, continues to finance and service the Company's requirements for new fixtures. Since no new Zayre stores were opened during 1975, only $750,000 in this type of term financing was placed during the year; however, a total of $8,872,000 was retired through the normal operation of the leasing program.

The equipment promissory notes carry interest rates that fluctuate with the prime rate and are amortized over approximately the same term as the underlying assets are depreciated.

Looking ahead, since more of our capital spending is to be devoted to store renovations, annual fixture loan placements will tend to be less than in the past. This means that the aggregate outstanding debt of Zayre Leasing Corporation should steadily decline.

The wholly-owned Zayre realty subsidiaries own three of our distribution centers and 18 shopping centers, with Zayre stores as the principal tenant of all but one. Zayre Corp. maintains a 50 percent interest in a real estate development company which operates 19 shopping centers having Zayre stores as the principal tenant.

Financial Commentary — The Company places great emphasis upon maintaining adequate working capital for its operations. We have consistently and carefully provided for our overall capital requirements in advance of need through the growth of net worth and the periodic additions of long-term debt with properly staged maturities.

Current instalments of long-term debt are $9,797,000, including Zayre Leasing. Only $350,000 of that total pertains to general corporate debt. For further information concerning the maturities of long-term debt, see page 20, Note A.

Our policy of financing capital additions with long-term funds through our wholly-owned leasing and realty subsidiaries has enabled the Company to concentrate its working capital primarily in support of its principal business — merchandising.

Working capital stands at $134,042,000, or 12.3 percent of total sales volume and $27.27 per share, up from $128,825,000 in 1974 and $87,294,000 five years ago. The year-end current ratio was 2.37.

These policies have permitted the Company to maintain sufficient short-term bank lines to accommodate seasonal merchandise needs and to consistently clear those lines before year-end.

We are continuing to steadily strengthen our balance sheet. A number of steps, referred to in the Letter to Shareholders, have been taken to employ our capital more efficiently and productively. Further, we are making greater use of internally generated funds — $16,475,000 from operations in 1975 — primarily earnings and depreciation, to provide for ongoing corporate growth.

A measure of this progress is reflected in the ratio of long-term debt to equity which has improved from 1.43 five years ago to 1.11 in 1974 and .99 this year. If real estate mortgages, which are not strictly a part of general corporate debt, are excluded, the ratio of long-term debt to equity is now .73.

Inventories — Year-end inventories totaled $187.8 million, up $10.1 million from the unusually low total of 1974, but well within our planned objectives.

The ratio of sales to year-end inventory was 5.77, somewhat less than the 5.89 achieved in 1974, but greater than the 5.20 recorded in 1973.

In recent years there has been a gradual improvement in our merchandise turnover reflecting improved inventory control and a better mix of sales. Going forward, this may be offset to some extent by our program to achieve higher in-stock positions in basics and advertised items.

Taxes — 1975 state and federal income taxes amounted to $5,034,000, representing 51 percent of pre-tax income.

Investment tax credits have been consistently reported as a reduction of the current provision for federal income taxes and amounted to $300,000 in 1975 and $522,000 in 1974.

In addition to state and federal income taxes and aside from sales taxes, our expenses include in excess of $19 million in property, payroll, and miscellaneous taxes.

Quarterly Results — Comparative quarterly sales and earnings (reclassified to reflect the discontinuance of owned credit) were:

(In thousands except per share amounts)

1975

Quarter	Sales	Income From Continuing Operations	Net Income	Per Share
First	**$ 221,567**	**$ (713)**	**$ (691)**	**$ (.15)**
Second	**268,711**	**1,894**	**1,913**	**.39**
Third	**242,083**	**1,297**	**1,261**	**.25**
Fourth	**351,650**	**4,378**	**2,457**	**.49**
	$1,084,011	**$6,856**	**$4,940**	**$ .98**

1974

Quarter	Sales	Income From Continuing Operations	Net Income	Per Share
First	$ 222,765	$ 454	$ 554	$ .11
Second	257,395	1,507	1,551	.31
Third	241,079	993	1,011	.20
Fourth	324,302	(2,290)	(2,284)	(.48)
	$1,045,541	$ 664	$ 832	$ .14

Management Discussion of the Summary of Operations — These comments relate to the Summary of Operations on page 7 and should be read together with the Letter to Shareholders and the Financial and Operating Review.

1974 vs 1973 — 1974 was marked by growing inflation, rising unemployment, and declining consumer confidence. In the resultant poor economic environment, the Company did not achieve adequate sales growth to offset the increase in its expenses.

Merchandise gross profit margins were adversely affected by heavy industry-wide inventory liquidations, especially in the fourth quarter, which resulted in unusually high markdowns. In addition, an increase in inventory shrinkage was experienced.

Selling, general and administrative expenses increased as a result of additional stores and inflation.

Primarily as a result of new stores, rent rose $2,940,000 in 1974.

Taxes, other than state and federal income taxes, rose $1,552,000 over 1973. Income taxes decreased due to lower earnings.

Interest costs, principally due to the marked increase in short-term rates, rose by $4 million.

1975 vs 1974 — The first quarter, which coincided with the bottom of the recent economic recession, reflected a decline in sales. Thereafter, a gradually improving sales performance ensued which, together with better merchandise margins, strong expense controls, and lower interest costs, resulted in higher quarterly earnings than in 1974.

Improved merchandise margins were achieved through the development of a more profitable mix of sales as well as a significant reduction in markdowns which together more than offset a further increase in inventory shrinkage and promotional price reductions.

Selling, general and administrative expenses grew in dollar amount but were held to the same percentage of sales as in 1974.

Interest costs decreased by $5.2 million due to the marked decline in money rates from the abnormally high levels of 1974 as well as reduced use of short-term borrowings during the year.

Income taxes increased because of substantially higher earnings and are commented on in Note F to the Financial Statements.

An after-tax reserve for discontinued operations was recorded in the amount of $1,880,000 to cover all current and future costs connected with the discontinuance of the Company's owned revolving charge credit plan and the sale of the related receivables (refer to page 4 in the Letter to Shareholders).

Earnings for Fiscal 1976 include a one-time before-tax reserve of $1,600,000 for the projected costs of closing and subletting the Company's six Spree! toy and leisure-time specialty stores.

Price Range of Common Stock — The common stock of the Company is listed on the New York Stock Exchange (Symbol: ZY). Quarterly high and low dollar closing prices were:

	1975		1974	
	High	**Low**	High	Low
1st Quarter	**$6**	**$4**	$7⅜	$5⅜
2nd Quarter	**6¼**	**4⅝**	6	3¾
3rd Quarter	**6¾**	**4⅝**	4⅜	2⅞
4th Quarter	**7¼**	**5½**	4¾	2½

New Officers — Since the publication of our last annual report, the following promotions and elections have been made by the Board of Directors:

To Vice President:

Leo Decker — *Regional Manager*
Norman Lenox — *Disbursements*
Joseph C. Murania — *Corporate Controller*
Monte A. Wolfson — *Merchandising*

To Assistant Vice President:

Stanley Berkovitz — *Consumer Affairs*
Philip M. Chrusz — *Merchandise Controller*
Nathaniel Marks — *Hit or Miss*
Stephen McNeeley — *Sales/Operations*
William F. Nandor — *Apparel Stores*
Ronald R. Reed — *Sales/Operations*
Harvey Resnik — *Merchandising*
Stephen C. Wener — *Merchandising*
Charles Whittle — *Management Information Systems*
Ira R. Willcox — *Management Information Systems*

To Assistant Secretary: Edward J. Weisberger

Excitement!

A very special word in retailing.

When presented with imagination and drama, there's as much excitement in cookware as there is in fashion apparel.

In 1975, Zayre embarked on a program to improve merchandise displays, to modernize and clarify store signs, and to make shopping more convenient. This will be a way of life in the future.

The photographs on the next three pages illustrate some of this excitement: in women's apparel, colorful domestics departments, massive toy assortments, and the highlighting of contemporary shoe fashions.

1975 saw substantial improvements and new excitement in Zayre stores. The quotes culled from our mail, and reprinted on the next three pages, indicate that our customers think so, too.

"I wore the dress I bought at Zayre to a banquet at the Bahamas, and it was just as lovely as any girl's there."

A. H.
Chicago, ILL.

"I went shopping at Zayre and bought three dresses, one pair of Jeans, two pairs of shoes, one belt, and one knit top — all for only $64!"

J. C.
Birmingham, AL

"I have tried every kind of diaper but found Zayre Cuddletowne Diapers the best."

K. R.
North Miami Beach, FL

"The James gang would have looked as good as the 'T.' gang if Zayre was around then. We bought shirts, pants, belts, sneakers, and socks for only $105.00. You can't do better than Zayre!"

M. T.


bed & bath
Bath Carpet


MATTEL Preschool
TUFF STUFF
SHOPPIN BASKET
Record Player
Fisher-Price Toys
Music Box
Record Player
SHES A
BLONDE!
SHES A
BRUNETTE
19 INCHES

"Zayre is where I spend my week's pay (smile). I have four girls and I buy all of their clothes from Zayre, plus my own."

J. J.
Homestead, FL

CONSOLIDATED STATEMENTS OF INCOME

Zayre Corp. and Consolidated Subsidiaries

	53 Weeks Ended January 31, 1976	52 Weeks Ended January 25, 1975
	(In Thousands)	
Net sales, excluding sales of leased departments	**$1,084,011**	$1,045,541
Cost of sales, including buying and occupancy costs	**850,680**	827,159
Selling, general and administrative expenses	**196,117**	188,773
Depreciation and amortization	**11,971**	12,653
Interest costs	**11,142**	16,307
Less interest capitalized	**—**	(229)
Total expenses	**1,069,910**	1,044,663
Income from continuing operations before income taxes	**14,101**	878
Provision for income taxes	**7,245**	214
Income from continuing operations	**6,856**	664
Discontinued operations:		
Income (loss) from discontinued owned credit plan, net of applicable income taxes	**(36)**	168
Loss on disposal of owned credit plan, net of applicable income taxes	**(1,880)**	—
	(1,916)	168
Net income	**$ 4,940**	$ 832
Net income per common share:		
Primary and fully diluted		
Income from continuing operations	**$1.37**	$.11
Income (loss) on discontinued owned credit plan	**(.39)**	.03
Net income	**$ .98**	$.14

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED BALANCE SHEETS

Zayre Corp. and Consolidated Subsidiaries

	January 31, 1976	January 25, 1975
	(In Thousands)	
ASSETS		
Current assets:		
Cash	**$ 26,075**	$ 38,667
Marketable securities	**8,000**	—
Accounts receivable	**2,751**	3,559
Net assets related to discontinued owned credit plan	**2,710**	6,380
Refundable federal and state income taxes	**—**	2,550
Merchandise inventories	**187,786**	177,647
Prepaid expenses	**4,295**	4,656
Total current assets	**231,617**	233,459
Property at cost:		
Land and buildings	**40,566**	40,566
Leasehold costs and improvements	**22,164**	21,034
Furniture, fixtures and equipment	**94,511**	95,787
	157,241	157,387
Less accumulated depreciation and amortization	**63,223**	55,465
	94,018	101,922
Other assets	**3,567**	5,181
Goodwill	**4,880**	4,880
TOTAL ASSETS	**$334,082**	$345,442

The accompanying notes are an integral part of the financial statements.

	January 31, 1976	January 25, 1975
	(In Thousands)	
LIABILITIES		
Current liabilities:		
Current instalments of long-term debt	**$ 9,797**	$ 13,722
Accounts payable	**51,959**	60,433
Accrued expenses and other current liabilities	**27,437**	26,576
Federal and state income taxes (including current portion of deferred taxes $1,625 and $3,400)	**8,382**	3,903
Total current liabilities	**97,575**	104,634
Long-term debt, exclusive of current instalments:		
General corporate debt	**42,479**	42,607
Equipment promissory notes	**41,479**	49,274
Real estate mortgages	**29,195**	30,041
Deferred income taxes	**8,873**	9,362
SHAREHOLDERS' EQUITY		
Preferred stock, par value $1, authorized 1,000,000 shares, issued and outstanding 57,659 shares Series B cumulative convertible preferred stock	**58**	58
Common stock, par value $1, authorized 15,000,000 shares, issued and outstanding, 4,914,667 and 4,864,767 shares	**4,915**	4,865
Additional paid-in capital	**16,200**	16,083
Retained earnings	**93,308**	88,518
Total shareholders' equity	**114,481**	109,524
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$334,082**	$345,442

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Zayre Corp. and Consolidated Subsidiaries

	53 Weeks Ended January 31, 1976	52 Weeks Ended January 25, 1975
	(In Thousands)	
SOURCE OF WORKING CAPITAL		
Income from continuing operations	$ 6,856	$ 664
Charges to income not requiring working capital:		
Depreciation and amortization	11,971	12,653
Deferred income taxes, net of $(1,775) and $700 applicable to instalment receivables	(489)	1,554
Other, net	53	(565)
Funds provided from continuing operations	18,391	14,306
Income (loss) from discontinued operations	(1,916)	168
Total funds provided from operations	16,475	14,474
Additional long-term borrowings	750	7,100
Property disposals at net book value	1,343	568
Other, net	1,334	(715)
	$ 19,902	$ 21,427
APPLICATION OF WORKING CAPITAL		
Decrease in long-term debt	$ 9,519	$ 12,992
Purchase of 5¾% convertible subordinated debentures	—	374
Property additions	5,016	9,017
Dividends on Series B preferred stock	150	150
	14,685	22,533
Increase (decrease) in working capital	5,217	(1,106)
	$ 19,902	$ 21,427
DETAILS OF WORKING CAPITAL INCREASE (DECREASE)		
Increase (decrease) in current assets:		
Cash	$ (12,592)	$ 2,078
Marketable securities	8,000	—
Accounts receivable	(808)	(974)
Net assets related to discontinued owned credit plan	(3,670)	2,152
Refundable federal and state income taxes	(2,550)	2,550
Merchandise inventories	10,139	(13,871)
Prepaid expenses	(361)	731
	(1,842)	(7,334)
Increase (decrease) in current liabilities:		
Current instalments of long-term debt	(3,925)	4,398
Accounts payable	(8,474)	(10,130)
Accrued expenses and other current liabilities	861	2,126
Federal and state income taxes	4,479	(2,622)
	(7,059)	(6,228)
Increase (decrease) in working capital	$ 5,217	$ (1,106)

The accompanying notes are an integral part of the financial statements.

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS AND ADDITIONAL PAID-IN CAPITAL

Zayre Corp. and Consolidated Subsidiaries

	53 Weeks Ended January 31, 1976	52 Weeks Ended January 25, 1975
	(In Thousands)	
Retained Earnings		
Retained earnings at beginning of year	**$88,518**	$87,836
Net income	**4,940**	832
Dividend on Series B preferred stock	**(150)**	(150)
Retained earnings at end of year	**$93,308**	$88,518
Additional Paid-in Capital		
Balance at beginning of year	**$16,083**	$15,937
Excess over par value of common stock for options exercised	**117**	146
Balance at end of year	**$16,200**	$16,083

COMBINED BALANCE SHEETS

The Leasing Subsidiaries of Zayre Corp.

(Included in the Consolidated Balance Sheets)

	January 31, 1976	January 25, 1975
	(In Thousands)	
ASSETS		
Cash	**$ 6,997**	$ 12,224
Marketable securities	**2,000**	—
Accounts receivable and other assets	**293**	320
Due from parent and operating subsidiaries	**956**	—
Property at cost:		
Land and buildings	**40,566**	40,566
Furniture, fixtures, equipment and leasehold improvements	**102,475**	103,274
	143,041	143,840
Less accumulated depreciation and amortization	**57,053**	49,982
	85,988	93,858
Total assets	**$ 96,234**	$106,402
LIABILITIES		
Accounts payable and accrued expenses	**$ 1,738**	$ 1,074
Due to parent and operating subsidiaries	**—**	552
Long-term debt, including current instalments of $9,447 and $11,514	**80,121**	90,829
Deferred income taxes	**8,569**	7,430
Total liabilities	**90,428**	99,885
PARENT COMPANY'S EQUITY (Dividends of $1,500 were paid to the parent in 1976)	**5,806**	6,517
Total liabilities and parent company's equity	**$ 96,234**	$106,402

The accompanying notes are an integral part of the financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SUMMARY OF ACCOUNTING POLICIES

Fiscal Year. The Company's fiscal year ends on the last Saturday in January. The fiscal years ended January 31, 1976 and January 25, 1975 included 53 and 52 weeks, respectively.

Basis of Presentation. The financial statements of Zayre Corp. and Consolidated Subsidiaries include the financial statements of all the Company's wholly-owned operating and leasing subsidiaries.

Amounts applicable to Zayre Credit Corporation are included in the caption net assets related to discontinued owned credit plan in both years to reflect the anticipated disposal described in Note H. Accordingly, the financial statements at January 25, 1975 have been reclassified.

The Company's investment in a real estate development company and Remex, a joint venture which operates the Company's gasoline stations, both of which are 50% owned, are accounted for under the equity method and included in other assets. For further information concerning Remex, see page 8.

For information concerning the projected costs of closing the Company's toy and leisure-time specialty stores — Spree! — see page 4 and Note F.

Marketable Securities. Marketable securities are stated at cost which approximates market.

Merchandise Inventories. Inventories are stated at the lower of cost or market, using the retail method.

Goodwill. Goodwill represents the excess of purchase price incurred over the costs assigned to identified assets of companies acquired prior to November 1, 1970 and is not being amortized.

Depreciation and Amortization. For financial reporting purposes, the Company provides for depreciation principally by the use of the straight-line method as follows: buildings — 33 years; leasehold costs and improvements — shorter of the lease term or estimated useful life; and furniture, fixtures and equipment — 5 to 10 years.

Additions and refurbishings, unless of minor amount, are charged to the property accounts. Expenditures for repairs and maintenance are charged to income as incurred.

Debt discount and related issue expenses are amortized over the lives of the related debt issues.

Capitalized Interest. The Company capitalizes interest incurred as a result of interim financing for the development of real estate locations.

Pension Plan. The Company has a noncontributory retirement plan covering substantially all full-time employees. Effective January 1, 1976, employees who are twenty-five years of age and have completed one year of service are covered under this plan. Pension costs which are based upon accepted actuarial methods include current service costs and amortization of prior service costs over 30 years. The Company funds pension costs accrued.

Income Taxes. Deferred income taxes arise from income tax and financial reporting differences, principally with respect to customer instalment receivables and depreciation. The deferral related to the instalment receivables is classified with the current federal and state income tax liability. Investment credit is recognized as a reduction in the provision for federal income taxes in the year in which the related properties are placed in service.

The Company and all wholly-owned subsidiaries file a consolidated federal income tax return.

Net Income Per Common Share. Primary net income per common share is based upon the weighted average number of common and common equivalent shares outstanding in each year, after provision for dividend requirements on the preferred stock. Fully diluted net income per common share assumes full conversion of all convertible securities and the exercise of all stock options and warrants during the periods in which they were outstanding and were dilutive.

NOTE A — LONG-TERM DEBT

At January 31, 1976, long-term debt, exclusive of current instalments, consisted of the following:

General corporate debt:	
Promissory notes, interest at 5.8% to 8%, maturing January 31, 1978 to January 31, 1984	$ 1,426,000
8% sinking fund debentures, maturing August 15, 1977 to August 15, 1996 at $1,250,000 annually (effective interest rate of 8.9% after the reduction of the unamortized debt discount of $2,467,000)	22,533,000
Subordinated notes, interest at 5½%, maturing January 15, 1979	500,000
5¾% convertible subordinated debentures, net of $1,980,000 held in treasury, maturing December 15, 1979 to December 15, 1994 at $1,000,000 annually	18,020,000
	42,479,000
Equipment promissory notes, interest principally at ¼% above prime, maturing in fiscal years 1978 to 1981	41,479,000
Real estate mortgages, interest at 5½% to 10½%, maturing October 24, 1977 to January 1, 2001	29,195,000
	$113,153,000

The aggregate maturities of long-term debt outstanding at January 31, 1976 are as follows:

Fiscal Years	General Corporate	Equipment Notes and Real Estate Mortgages	Total
1978	$ 1,816,000	$ 9,163,000	$ 10,979,000
1979	1,919,000	8,161,000	10,080,000
1980	2,372,000	6,986,000	9,358,000
1981	2,375,000	7,220,000	9,595,000
Thereafter	33,997,000	39,144,000	73,141,000
	$42,479,000	$70,674,000	$113,153,000

The Company finances its furniture and fixture purchases with equipment promissory notes having an initial term of five years with a payment at the end of the fifth year which approximates 50% of the original balance. Traditionally, the Company has been successful in refinancing this balance for an additional period of five years. The data presented in the maturity schedule above assumes such refinancings. If these refinancings were not available to the Company, the aggregate maturities of "Equipment Notes and Real Estate Mortgages" would be: $19,838,000, $11,969,000, $8,672,000 and $3,215,000 in fiscal years 1978 through 1981, respectively, and $26,980,000 thereafter.

The subordinated notes are subordinated to the promissory notes and the sinking fund debentures. The 5¾% convertible subordinated debentures are subordinated to all other general corporate debt and are convertible into common stock at $40 per share, for which the Company has reserved 500,000 shares of its common stock. The Company has also reserved 300,000 shares of common stock for warrants issued in connection with the sinking fund debentures, exercisable at $40 and expiring on August 31, 1976.

During fiscal 1975, the Company acquired $930,000 in face value of its 5¾% convertible subordinated debentures on the open market using general corporate funds. The debentures were acquired at less than face value which resulted in net income to the Company of $255,000 or $.05 per share. These debentures together with $1,050,000 face value previously acquired can be used to meet sinking fund requirements.

While the parent company is not directly obligated with respect to the equipment promissory notes or real estate mortgages, it has guaranteed the leases which have been assigned as collateral for such debt. Real estate mortgages are collateralized by substantially all land and buildings.

NOTE B — SHORT-TERM BORROWINGS, COMPENSATING BALANCES AND CREDIT LINES

On March 7, 1975, the Company consummated an unsecured committed line of credit agreement with its present line banks which increased its existing short-term lines of credit to $89,500,000 of which $22,000,000 was available for use by Zayre Credit Corporation. The agreement, which expires on January 28, 1977, and may be renewed annually thereafter, provides for interest to be paid at the annual rate of ¼% above prime on outstanding borrowings through January 31, 1976, and ½% above prime thereafter. The agreement also provides for a ½% commitment fee on the average daily unused amount and a ¼% facility fee on the total committed amount. The agreement contains certain restrictive covenants which, among other things, include minimum working capital and net worth requirements and limitations as to capital expenditures, dividends and the incurrence of lease obligations and long-term debt. As a result of the discontinuance of Zayre Credit Corporation, the commitment to Zayre Credit Corporation will be canceled when the receivables are sold and the amount which will be then available to Zayre Corp. under the terms of the agreement will be decreased by approximately $6,500,000 to $83,000,000. The Company has the option to further reduce the available line of credit. Under the terms of the agreement, retained earnings at January 31, 1976 are not available for dividends on common stock.

During fiscal 1976 and 1975 short-term borrowings of the Company and Zayre Credit Corporation were as follows:

(Amounts in Thousands)

	Zayre Corp.		Zayre Credit Corporation	
	1976	1975	1976	1975
Maximum loans outstanding	$36,500	$66,000	$17,550	$17,250
Outstanding at fiscal year-end	-0-	-0-	$15,000	$17,250
Daily weighted average borrowings	$20,300	$40,300	$14,200	$14,000
Daily weighted average interest rate	7.86%	10.77%	8.09%	10.71%

The Company maintains compensating balances under informal arrangements with banks in connection with the lines of credit and its equipment promissory notes. Under substantially all of these arrangements, the Company is expected, but not legally required, to maintain average bank balances (including amounts resulting from normal timing differences in the recording of cash transactions by the Company and the banks) equal to 10% of its line of credit, 10% of its line of credit usage and 15% of the unpaid principal balances of equipment notes.

NOTE C — STOCK OPTIONS AND STOCK PURCHASE PLAN

Under its stock option plans, the Company has granted certain officers and key employees options for the purchase of common stock within five years from the grant date at option prices of 100% of market price on the grant date, exercisable at various times during the four-year period beginning one year after the grant date. At January 31, 1976 and January 25, 1975, 37,016 and 5,600 shares, respectively, were exercisable.

Option activity during fiscal 1976 was as follows:

		Number of Common Shares Reserved for	
	Option Prices	Options Granted	Future Options
Outstanding at January 25, 1975	$10.25	137,486	203,878
Options Granted	$5.56–$ 5.63	147,400	(147,400)
Cancellations	$5.63–$10.25	(18,465)	18,465
Outstanding at January 31, 1976	$5.56–$10.25	266,421	74,943

Of the gross proceeds realized by the Company upon the exercise of options, $1.00 per share (par value) is credited to its common stock account and the balance is credited to its additional paid-in capital account. There have been no charges to income in connection with the options other than incidental expenses related to the issuance of the shares.

Under its Executive Incentive Stock Purchase Plan, 68,020 shares of common stock were reserved at January 31, 1976 for sale at a price (not less than par value) determined by the Company, subject to repurchase options and restrictions on sales which lapse equally over five or ten

years. In fiscal 1976, 49,900 shares were sold for $1.00 per share under the plan.

The excess of the market price of these shares over the purchase price is charged to income ratably over the period during which the restrictions lapse. Such charges amounted to $117,000 in fiscal 1976 and $146,000 in fiscal 1975. The annual charge is reduced by applicable income taxes.

NOTE D — COMMITMENTS

The Company is committed under long-term leases for the rental of real estate (stores, warehouses and office facilities) and equipment (principally computer and automotive). The real estate leases range from 5 to 36 years, have varying renewal options and, in several leases, purchase options. In addition, the Company is generally required to pay insurance, real estate taxes, other operating expenses and in some cases rentals based on a percentage of sales. The equipment leases range from 3 to 11 years.

Some of the above leases meet the Securities and Exchange Commission's definition of financing leases since the non-cancelable lease period either (1) covers 75% or more of the economic life of the property or (2) has terms which assure the lessor a full recovery of the fair market value of the property at the inception of the lease, plus a reasonable return on his investment. Such "financing" leases are presented separately hereunder pursuant to this definition.

Total rental expense (net of sublease income which is not material) amounted to:

	1976	1975
"Financing" leases	$17,433,000	$17,436,000
Other leases	18,551,000	18,021,000
	$35,984,000	$35,457,000

At January 31, 1976, the minimum commitments under non-cancelable leases with an initial or remaining term of greater than one year are presented below. These leases are primarily real estate leases and are presented net of subleases.

Fiscal Years	"Financing"	Other	Total
1977	$16,889,000	$17,739,000	$ 34,628,000
1978	16,818,000	17,520,000	34,338,000
1979	16,676,000	16,975,000	33,651,000
1980	16,653,000	16,387,000	33,040,000
1981	16,399,000	15,803,000	32,202,000
1982-1986	71,092,000	66,701,000	137,793,000
1987-1991	62,238,000	47,440,000	109,678,000
1992-1996	50,920,000	34,468,000	85,388,000
Thereafter	27,149,000	7,218,000	34,367,000

The estimated present values of "financing" leases which amount to $144,770,000 and $148,550,000 as of January 1976 and January 1975, respectively, were determined by discounting the net lease payments at interest rates estimated to be inherent in the terms of the leases. The interest rates used to compute present values range from 5% to 11% (weighted average rate of 8.6% in both years).

If the above "financing" leases were capitalized and amortized on a straight-line basis over the initial terms of the leases and interest were accrued on the outstanding lease liabilities, net income would have been reduced by approximately $1,101,000 and $1,575,000 in 1976 and 1975, respectively. This computation includes amortization of present values of $7,497,000 and $7,618,000 and interest of $12,331,000 and $12,846,000 in 1976 and 1975, respectively.

The above amortization is greater than the depreciation that would have been charged if the leased properties were owned, because no amount has been allocated to land and the amortization is over the lease term rather than the longer economic life of the property which would have been used for depreciation.

NOTE E — PREFERRED STOCK

The Series B $2.60 cumulative convertible preferred stock is entitled to a liquidation preference of $65 per share, or $3,748,000 in the aggregate, and is redeemable at the option of the Company at the same price. Each share is convertible into 1.5 shares of common stock and 86,488 shares of common stock have been reserved for the conversion privilege.

NOTE F — INCOME TAXES

The provision for income taxes includes the following:

	1976	1975
Continuing operations:		
Federal:		
Current	$ 6,435,000	$ (2,584,000)
Deferred	(714,000)	2,178,000
State:		
Current	1,699,000	544,000
Deferred	(175,000)	76,000
	7,245,000	214,000
Discontinued operations:		
Federal:		
Current	(659,000)	156,000
Deferred	(1,125,000)	—
State:		
Current	(177,000)	36,000
Deferred	(250,000)	—
	(2,211,000)	192,000
Total income tax expense	$ 5,034,000	$ 406,000
Investment credit included above as a reduction of the current provision for federal income taxes on continuing operations	$ 300,000	$ 522,000
Deferred income tax expense was attributable to:		
Excess of tax over book depreciation	$ 850,000	$ 1,800,000
Deferral for tax purposes of gross profit on instalment accounts receivable	(400,000)	700,000
Anticipated losses from discontinued operations	(1,375,000)	—
Anticipated losses from closing of Spree! stores	(850,000)	—
Pension expense	(275,000)	—
Other, net	(214,000)	(246,000)
	$ (2,264,000)	$ 2,254,000

The Company estimates that its cash payments for income taxes will not exceed its tax provisions in any of the next three years.

The following is a reconciliation between the statutory federal income tax rate and the fiscal 1976 and 1975 effective income tax rates:

	1976	1975
Statutory federal income tax rate	**48%**	48%
Investment tax credit	**(3)**	(42)
State income taxes net of federal tax benefit	**6**	27
Effective income tax rate	**51%**	33%

State income taxes in 1976 declined ratably as a percentage of income primarily because of the inclusion in both years of state taxes based on gross receipts and the filing of separate returns for state tax purposes.

NOTE G — PENSION EXPENSE

Pension expense amounted to $642,000 and $899,000 for fiscal 1976 and 1975, respectively. During fiscal 1976, the actuarial assumptions regarding employee turnover rates were refined to more closely reflect the Company's actual experience. The resulting $300,000 reduction was partially offset by an increase in the compensation base. At December 31, 1974, the date of the most recent actuarial valuation, there were no unfunded prior service costs. As of the valuation date, the plan assets exceeded the actuarially computed value of vested benefits.

Studies concerning the requirements for changes to the pension plan in accordance with the Employee Retirement Income Security Act of 1974 have not yet been completed. However, based upon preliminary findings increased annual contributions which may be required will not be material.

NOTE H — DISCONTINUED OPERATIONS

On March 12, 1976, the Company entered into an agreewith General Electric Credit Corporation, which now operates a Zayre revolving charge plan in 101 of the Company's stores, to extend that operation into 52 additional stores in which the Company operates its own plan. As a result of this transaction, which will be concluded in July, 1976, and upon fulfillment by both parties of certain conditions normal to such agreements, General Electric Credit Corporation will purchase, at a discount, with limited recourse, substantially all of the Company's more current customer accounts receivable. The balance of the accounts receivable will be collected by the Company.

The Company has provided $1,880,000 net of applicable income tax benefits, for estimated losses, including future operating losses of $232,000, in connection with this disposal.

Net assets related to discontinued owned credit plan consists of:

	January 31, 1976	January 25, 1975
Equity in and receivables from Zayre Credit Corporation	**$ —**	$5,127,000
Related receivables held by the operating companies	**—**	1,253,000
Customer instalment receivables, net of allowance for uncollectable accounts of $1,637,000	**21,932,000**	—
Reserve for loss related to disposal of owned credit plan	**(4,050,000)**	—
Short-term notes payable to banks to be repaid from proceeds of liquidation and disposal	**(15,172,000)**	—
	$ 2,710,000	$6,380,000

At January 25, 1975 Zayre Credit Corporation had customer instalment receivables aggregating $22,070,000 and short-term notes payable to banks of $17,250,000.

ACCOUNTANTS' REPORT

COOPERS & LYBRAND

CERTIFIED PUBLIC ACCOUNTANTS

IN PRINCIPAL AREAS OF THE WORLD

To the Board of Directors of Zayre Corp.:

We have examined the consolidated balance sheet of Zayre Corp. and Consolidated Subsidiaries as of January 31, 1976, and the related consolidated statements of income, retained earnings, additional paid-in capital, and changes in financial position for the fiscal year then ended. We have also examined the combined balance sheet of the Leasing Subsidiaries of Zayre Corp. as of January 31, 1976. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the above financial statements for the fiscal year ended January 25, 1975.

In our opinion, the aforementioned financial statements present fairly the financial position of Zayre Corp. and Consolidated Subsidiaries and the Leasing Subsidiaries of Zayre Corp. at Janaury 31, 1976 and January 25, 1975 and the results of operations and changes in financial position of Zayre Corp. and Consolidated Subsidiaries for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Boston, Massachusetts
March 23, 1976

Coopers + Lybrand

DIRECTORS & OFFICERS

DIRECTORS

*MAX FELDBERG	*Honorary Chairman*
*SUMNER FELDBERG	*Chairman*
*STANLEY H. FELDBERG	*President*
*MILTON L. LEVY	*Chairman Executive Committee Senior Vice President*
*BURTON S. STERN	*Executive Vice President*
†N. PRESTON BREED	*Consultant, State Street Boston Financial Corporation*
†ALBERT M. KRONICK	*Consultant*
△NEWTON A. LANE	*Partner, Nathanson & Rudofsky*
△WALTER J. SALMON	*Associate Dean of Educational Affairs, Harvard Graduate School of Business Administration*
†ROBERT F. SHAPIRO	*Executive Vice President, Wertheim & Co. Inc.*
△VINCENT C. ZIEGLER	*Chairman of the Executive Committee, The Gillette Company*

*member of the Executive Committee
†member of the Audit Committee
△member of the Compensation Committee

OFFICERS

MAX FELDBERG	*Honorary Chairman*
SUMNER FELDBERG	*Chairman of the Board*
STANLEY H. FELDBERG	*President*
DAVID KAPLAN	*Executive Vice President, Sales/Operations*
BURTON S. STERN	*Executive Vice President, Merchandising*
MILTON L. LEVY	*Chairman Executive Committee, Senior Vice President, Real Estate*
ARTHUR F. LOEWY	*Senior Vice President, Finance, and Treasurer*
JOHN F. McGOWAN	*Senior Vice President, Sales/Operations*
MALCOLM L. SHERMAN	*Senior Vice President, General Merchandise Manager*

Vice Presidents

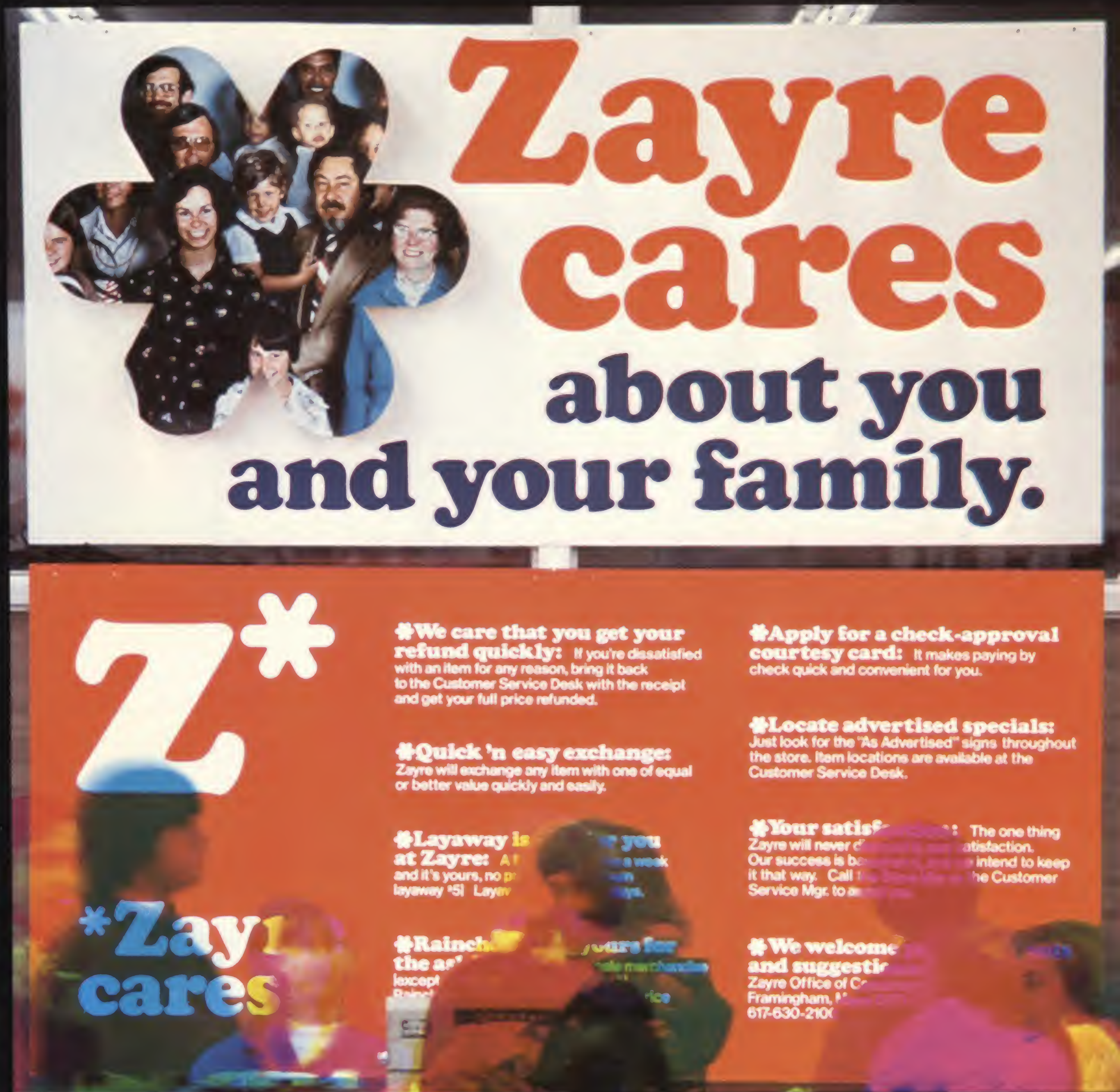
GERALD DAVIS	*Merchandising*
IRVING LIEF	*Merchandising*
THEODORE SCHOENFELD	*Merchandising*
KARAM SKAFF	*Merchandising*
MONTE A. WOLFSON	*Merchandising*
ROBERT ALGER	*Regional Manager*
LEO DECKER	*Regional Manager*
JOSEPH HALPER	*Regional Manager*
RUDY HUNTER	*Regional Manager*
GEORGE MOVER	*Regional Manager*
LEONARD OPPENHEIMER	*Regional Manager*
L. R. BENNETT	*Shoppers' City*
ROBERT FEINBERG	*Beaconway*
GEORGE FREEMAN	*Staff/Finance*
RICHARD JOHNSON	*Real Estate*
NORMAN LENOX	*Disbursements*
SAMUEL LYNCH	*Management Information Systems*
JOSEPH C. MURANIA	*Corporate Controller*
STANLEY SCHLESINGER	*Sales/Operations*
ROBERT SHEDD	*Finance/Assistant Treasurer*
LEE A. SILVER	*Personnel*
WARNER STRAUSS	*Distribution Services*
HERBERT ZARKIN	*Advertising and Sales Promotion*

Assistant Vice Presidents

STANLEY BERKOVITZ	*Consumer Affairs*
PHILIP M. CHRUSZ	*Merchandise Controller*
JOSEPH DENARO	*Credit*
HERSHEL DENKER	*Business Planning*
DAVID GOLDMAN	*Hit or Miss*
TIMOTHY HART	*Market Research*
STEPHEN HERMAN	*Corporate Planning*
RANDOLPH L. KRUGER	*Management Information Systems*
SEYMOUR LEVINE	*Sales/Operations*
NATHANIEL MARKS	*Hit or Miss*
STEPHEN McNEELEY	*Sales/Operations*
WILLIAM F. NANDOR	*Apparel Specialty Stores*
C. A. ONOFRIETTI	*Security*
RONALD R. REED	*Sales/Operations*
HARVEY RESNICK	*Merchandising*
IRVING RITZ	*Personnel*
CALVIN SALTZMAN	*Merchandising*
CHARLES SELF	*Financial Controller*
STEPHEN C. WENER	*Merchandising*
CHARLES WHITTLE	*Management Information Systems*
IRA R. WILLCOX	*Management Information Systems*

Secretary Newton A. Lane

Assistant Secretaries Dermot B. Moylan
Edward J. Weisberger



Transfer Agents — Common Stock
State Street Bank and Trust Company
Boston, Massachusetts
Irving Trust Company
New York, New York

Registrars — Common Stock
The First National Bank of Boston
Boston, Massachusetts
The Chase Manhattan Bank
New York, New York

Trustee — Convertible Subordinated Debentures
Citibank, N.A.
New York, New York

Trustee — Sinking Fund Debentures
Bankers Trust Company
New York, New York

Listing
New York Stock Exchange
(Common Stock and Debentures)

Executive Offices
Framingham, Massachusetts

Auditors
Coopers & Lybrand

General Counsel
Nathanson & Rudofsky

Special Counsel
Ropes & Gray

Zayre Corp.

Framingham, Massachusetts 01701